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IFRS 4 Phase 2 Seminar

Institute of Actuaries of India

Mumbai

September 6, 2013

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Overview and Key Proposals

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- Scope
- Separating elements of an insurance contract
- Overview of the measurement model
- Contractual service margin
- Acquisition costs
- Participating contracts
- Financial statement presentation
- OCI
- Asset accounting
- Transition

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Scope

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IFRS 4 Scope

- Insurance contracts, including reinsurance contracts, issued by an entity
- Reinsurance contracts held by an entity
- Investment contracts with discretionary participating features (DPF's)

➢ Therefore the first step in applying IFRS 4 is to determine the appropriate product classification

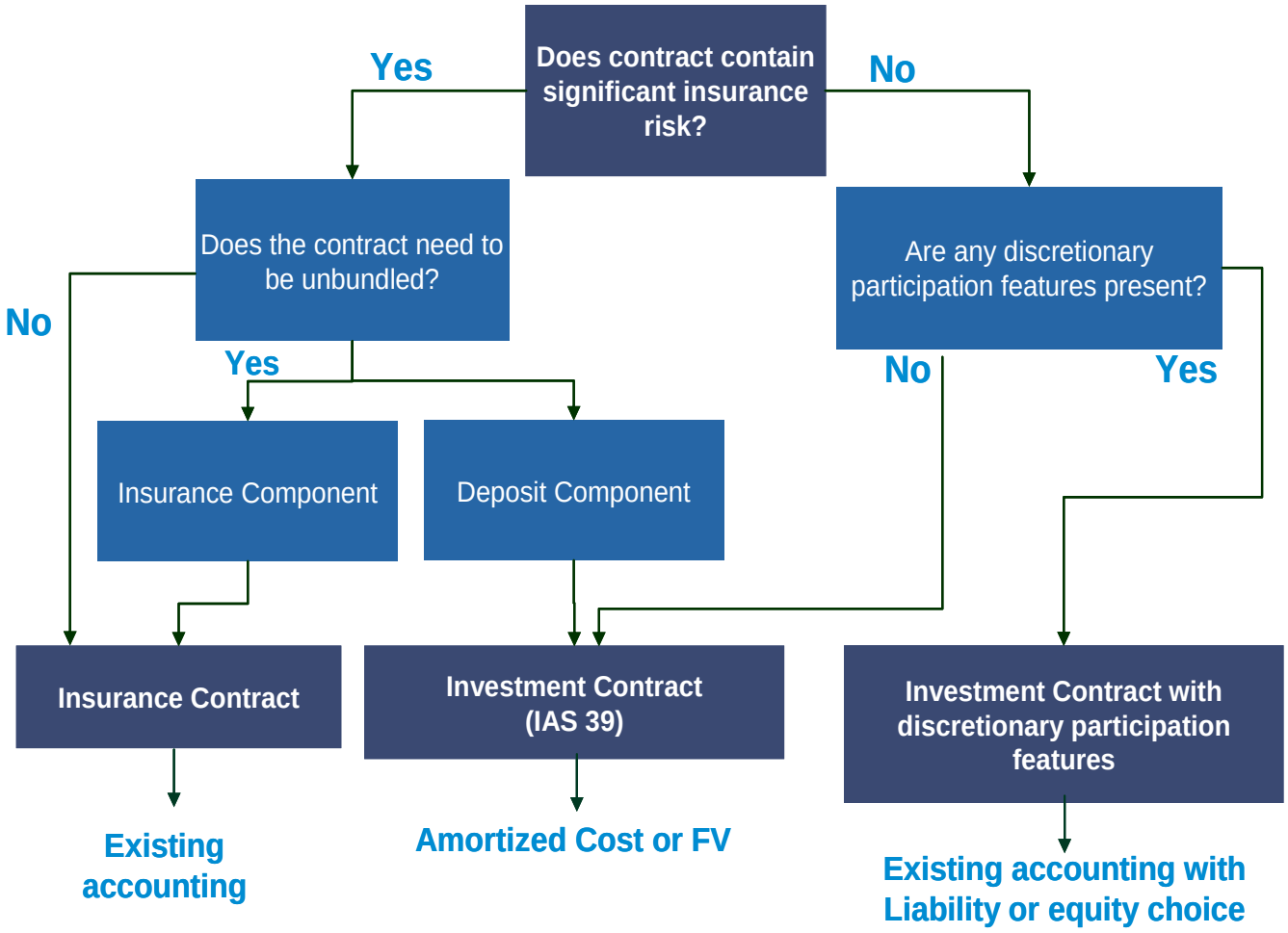
IFRS 4 - Insurance Contract Definition

- A single definition of insurance contracts

  *"a contract under which one party (the **insurer**) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the **insured event**) adversely affects the policyholder."*

- "A reinsurance contract is a type of insurance contract."

Product Classification



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Separating Contract Elements

For Separate Measurement

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Embedded Derivatives

- Separate an EDs if and only if:
  - The ED is not closely related to the host (Most common demonstration is debt versus equity characteristics)
  - If separated, the ED meets the definition in IFRS 9

- If a contract contains an ED, value it first, the value the remaining contract in accordance with the Exposure Draft

Investment components

- Unbundle is to separate and separately measure the investment component. Done if the IC is deemed distinct from the insurance component

- Unbundle if:
  - IC is separately sold in the same market and jurisdiction *(but this may lead to differences in different markets)*
- Do not unbundles if:
  - policyholder cannot lapse one without the other, or
  - they are not sold separately, or
  - can only value one with the other

- Asset management fees part of investment component
- Policy loans are part of deposit element and unbundled with them

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Separating Contract Elements:

For FS Presentation Only

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Separating investment components

- If not already unbundled, investment components must be removed from revenue and benefits in the presentation model
  - This includes any “returnable amounts” that would be returned to the policyholder if the insured event did not occur
  - Examples are the surrender value even if the underlying product is primarily a protection product.
  - Should be removed from premium and claims
  - However, these still follow the overall IC model

Separating investment components

- With the exception of term life or life contingent pay-out annuities, the majority of contracts will have some aspect of a returnable amount
- There are also additional disclosure requirements for these amounts.
- Brings another layer of complexity to the overall calculation and presentation

Example 1

- "105" single premium product where the death benefit is 105% of the account value
  - If the paid premium is $1000 with no front end loads, what is recognized as revenue in the Profit and Loss statement?
  - Policyholder dies when the AV = $1100. What is the benefit shown in the Profit and Loss statement?

Example 2

- Whole life product with DB of $40,000
  - If the paid premium is $1000, how much is recognized as revenue in the Profit and Loss statement if:
    - PV of total expected premiums = $20,000
    - PV of total expected DB = $5,000
    - PV of total expected surrender values = $10,000
  - Policyholder dies when the cash value = $5,000. What is the claim listed in the Profit and Loss statement?

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Overview of the Measurement Model

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Measurement Model Background

Measurement model principles

- Measurement model based on the following principle:
  - Insurance contracts create a bundle of cash flows that work together to create a package of cash inflows and outflows
- Measurement model proposed for all types of insurance (and reinsurance) contracts
- Model is a current assessment of insurer's rights and obligations under contract
- Model has three building blocks
- A modified approach for short-duration contracts

Current fulfillment value

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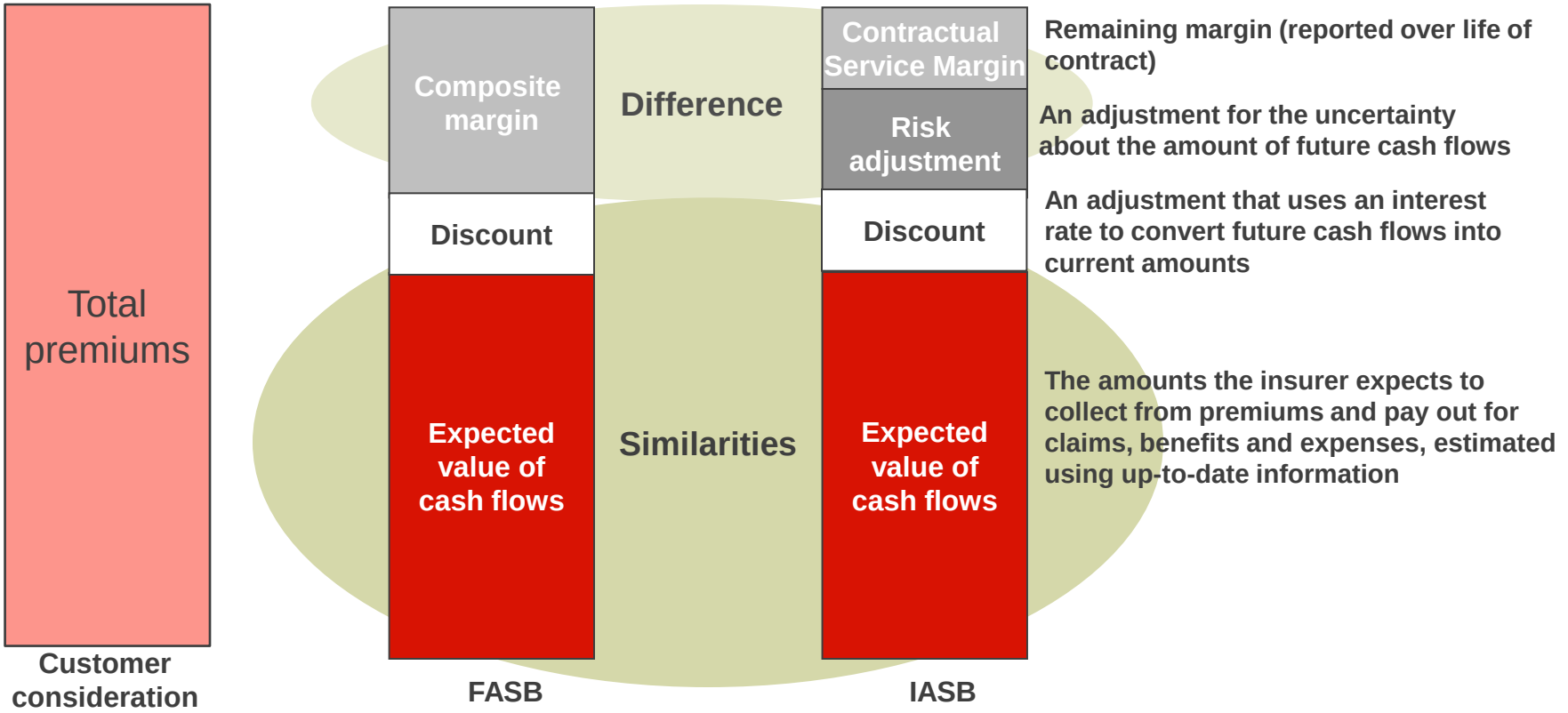

Difference between IASB and FASB Guidance

Margin Approach

- The IASB and FASB have confirmed the above approaches and will not converge to a single opinion on margins

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Building block 1: Cash flows estimate

A current, unbiased and probability weighted estimate of the contractual cash flows

- Current — re-assessed at each reporting period
- Incorporate, in an unbiased way, all available information about the amount and timing of all cash flows
- Probability weighted cash flows — Stochastic modeling may be required
- If observable market data exists, incorporate in the model to the extent possible
- Non-market variables utilize entity-specific cash flows

Which cash flows are included?

- Includes all cash flows that arise as the insurer fulfills the insurance contract:
  - Premiums and cash flows that arise within the “contract boundary”
  - Claims and benefits paid to policyholders, plus associated costs
  - Surrender and participating benefits
  - Cash flows resulting from options and guarantees
  - Costs of selling, underwriting and initiating that can be directly attributable to a portfolio level
  - Transaction-based taxes and levies
  - Policy administration and maintenance costs
  - Some overhead-type costs such as claims software, etc

Which cash flows are excluded?

- Excludes the following cash flows as the insurer fulfills the insurance contract
  - Investment returns
  - Payments to and from reinsurers
  - Cash flows that may arise from future insurance contracts
  - Acquisition costs not directly attributable to obtaining the portfolio of contracts
  - Cash flows arising from abnormal amounts of wasted labor
  - General overhead
  - Income tax payments and receipts
  - Cash flows from unbundled components

Building block 2: Discount rate

Adjusts first building block for time value of money

- Discount rate based on characteristics of the insurance liability:
  - Currency
  - Duration
  - Liquidity
- Use an **asset based discount rate ONLY** if the amount, timing or uncertainty of the cash flows depend on performance of assets, e.g. **participating contracts**
- Discount rate is a market consistent interest rate based on a **"risk free rate" plus an illiquidity premium** based on the characteristics of liability cash flows ("bottom-up" approach).
  - **Top-down approach**: starting from expected asset returns for a reference portfolio, the entity then removes factors that are not relevant to the insurance contracts (such as market risk premiums for assets included in the reference portfolio) and adjusts for differences between timing of cash flows between the assets and the cash flows of the insurance contracts.
- No further guidance on how to calculate the illiquidity premium

Building block 3: Margins – Risk adjustment

An adjustment to reflect uncertainty in the estimate of fulfillment cash flows

- Explicitly reported as a component of the insurance contract liability, defined as:

  "The compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfills the insurance contract."

- Re-measured at each reporting period; Estimated at portfolio level
- Reflects the degree of diversification benefit that the entity considers when determining the compensation it requires for bearing that uncertainty
- No specific technique required under the IASB guidance. Required confidence level disclosure. (2010 ED had specified three permitted methods)

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Contractual Service Margin

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Building block 3: Margins – Contractual Service Margin

A margin to eliminate any gain at inception of the contract

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- A contractual service margin (known previously as the 'residual margin') arises when:

  PV of future cash inflows > PV of future cash outflows + Risk Adjustment

- The purpose of the contractual service margin is to prevent a gain at issue.

$CSM_0 = PV_0$ (Premiums – Benefits & Expenses) – Risk Adjustment

$= - GPV_0$ – Risk Adjustment

Building block 3: Margins – Contractual Service Margin (con't)

A margin to eliminate any gain at inception of the contract

- CSM_0 can be thought of as the present value of future profits. CSM_t can be thought of as the present value of future profits at time t.
- Initially estimated and amortized at the level of portfolio of insurance contracts, with same inception date. ("cohort" concept)
  - "Portfolio" means polices with similar risk characteristics and managed together
- Calculated at initial recognition and amortized in subsequent valuations.
- Cannot be negative, as a loss must be recognized immediately through income

Contractual Service Margin Amortization

- .Key questions addressed in the 2013 ED :

  - Q: Over what period should the CSM be amortized? A: Coverage period
  - Q: What is reasonable amortization basis? A: Amortization must reflect the transfer of services in a systematic way
  - Q: Should interest be accreted? A: Yes, at the rate used to discount cash flows when the CSM was initially determined
  - Q: Should the amortization be unlocked? A: Yes, the entity shall adjust the CSM to reflect favorable and unfavorable change in the future cash flows (i.e., unlocking).
  - Q: At what level should the amortization take place? A: The same level

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Acquisition Costs

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Definition of acquisition costs

- Directly attributable acquisition costs are included in the fulfillment cash flows.
  - The costs are assessed at the portfolio level and include costs that cannot be attributed directly to individual contracts.
  - Costs must be allocated on a “rational and consistent basis”.
- This is a significant change from the 2010 ED where acquisition costs were assessed at the individual contract level.
- Also a major difference from US GAAP, where acquisition costs must be associated with “successful efforts”.

Treatment of acquisition costs

- Acquisition costs are considered policy cash flows.
- As such they serve to increase the PV (fulfillment cash flows) as at the issue date, i.e. making it less negative than if they were not considered.
- Hence the CSM is smaller than if acquisition costs were not considered
- The effect is to defer acquisition costs

More acquisition cost → less negative PV_0(fulfillment cash flows) → lower CSM at issue → less year one strain, but lower profits in year 2 and later

Example – SP 10 Year Pure Endowment Liability Values

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Time = 0	Company A	Company B
Premium	100	100
Direct Acquisition Costs	10	0
Non-direct Acquisition Costs	0	10
Total Benefit	60	60
Risk Adjustment	10	10
Current Fulfillment Value	-20	-30
CSM	20	30
Total Liability	0	0

Time = 1	Company A	Company B
Premium	0	0
Direct Acquisition Costs	0	0
Non-direct Acquisition Costs	0	0
Total Benefit	54	54
Risk Adjustment	9	9
Current Fulfillment Value	63	63
CSM	18	27
Total Liability	81	90

- Relief of $9 results from $10 expenses incremental

Example – SP 10 Year Pure Endowment
Year 1 Income Statement (ignore interest)

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Statement of comprehensive income	Company A	Company B
Revenue		
Change in risk adjustment	1	1
Release of contractual service margin	2	3
Contract Revenue (expected claims and exp.)	7	7
Total	10	11
Expense		
Indirect Costs	0	10
Claims	7	7
Total	7	17
Net income before tax	3	-6

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Participating Contracts and Mirroring

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"Participating" Contracts

- The ED does not use the term "participating" contracts.
- The IASB has struggled to define the appropriate measurement model for contracts where the cash flows depend in part on the supporting assets. These include:
  - Gated par, such as exists in India, the UK and elsewhere
  - Unit linked products
  - Universal life products
- There is terminology for liabilities that are "linked" to assets
- *ED's goal is to eliminate accounting mismatches where economic mismatches are impossible which is potentially both more broad and more restrictive than just Par*

New definition

33 An entity shall apply paragraph 34 if the contract:

a) **requires the entity to hold underlying items** such as specified assets and liabilities, an underlying pool of insurance contracts, or if the underlying item specified in the contract is the assets and liabilities of the entity as a whole; and

b) **specifies a link** between the payments to the **policyholder** and the returns on those underlying items.

The entity shall determine whether the contract specifies a link to returns on underlying items by considering all of the substantive terms of the contract, whether they arise from a contract, the law or regulation.

How do they fit into the model?

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Decompose the cash flows into possible 3 parts:

- Variable cash flows that depend on the underlying items
  - Measured by reference to their carrying value, because the entity will not suffer any economic mismatches
- Indirectly varying cash flows (usually options and guarantees)
  - Recognized in profit or loss, not OCI or against the CSM and may include significant volatility
  - Likely a different discount rate than fixed cash flows to reflect this linkage
  - Also likely require a stochastic approach to value. If so, do they need to be market consistent (which then may not show the linkage)
- Fixed independent cash flows
  - Measured like the standard cash flows with parts split between P&L, OCI and CSM

Why split?

Variable cash flows that depend on the underlying items

- There is no possibility of an economic mismatch
- Therefore, this exception is created to eliminate any accounting mismatch and record the same amount as the asset is listed on the balance sheet

Indirectly varying cash flows (usually options and guarantees)

- Still a possibility of economic mismatch but the discount rate should be based on the characteristics of the cash flows
- The linkage of these to the assets should be reflected

Fixed independent cash flows

- Recognize there are cash flows that are fixed so should use the standard discount rate

How do we decompose the CF?

Two criteria

- Maximize the extent to which they vary with the underlying
- Minimize fixed payment the policyholder will receive

Example

- 90% of assets at the end of a period with a guaranteed minimum return

90% of assets	Variable is maximized
Put option on 90% of assets with strike of $900	Remainder is the indirectly varying cash flows
Fixed payment of $100	Fixed is minimized

How do we decompose the CF?

Return on Assets	30%	20%	10%	0%	-10%
90% of Assets	1,170	1,080	990	900	810
Fixed payment of $100	100	100	100	100	100
90% put with $900 strike	0	0	0	90	90
Total Liability	1,270	1,180	1,090	1,000	1,000
Asset (for reference)	1,300	1,200	1,100	1,000	900

Observation:

Profit for the insurer will depend on whether or not the fixed payment and put was hedged or if the insurer also took on asset risk

How do we decompose the CF?

Consider a 90/10 gated whole life product that pays policyholders a dividend equal to 90% of surplus created by the products and the undistributed past surplus is ring fenced

- Assume it meets the definition of “required” and “linked”

What is the variable piece?

- 90% of the past surplus?
- 90% of the current assets supporting the future liabilities?
- What about deviations in mortality and lapse affecting surplus? Should these be considered?

What is the fixed piece? - The guaranteed minimum cash flows

What is the indirect piece?

How do we determine the Discount rate?

For indirectly linked cash flows, the discount rate should reflect this linkage.

What if, for a HK par (with full discretion of dividends), management pays based on the following:

- Maintaining a stable dividend amount for all policyholders across several years
- Achieving a target spread on book yield of assets for shareholders
- Considering what competitors are crediting
- Considering how it will affect what policyholders leave on deposit where the insurer can earn an additional spread

What is the linkage and how would it be reflected in the discount rate?

Replicating Portfolios

- The ED suggests but does not require that replicating portfolios may be able to solve some of these issues
  - It also suggests they can be used for market variables and risk margins
  - It also implies that a blended discount rate may also be appropriate with no need to separate cash flows
- How to apply this may still be a challenge

Where does that leave us?

- The goal is to eliminate accounting mismatches where economic mismatches
- The proposed model is an attempt with considerable implementation issues
- Does it reach that goal considering the potential volatility on the indirectly linked treatment?
- Is there a better model that is also applicable to the country-specific variations around the world?
- This is an area where substantial comments (and disagreements) are certain.

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Presentation

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Rationale for the 2013 Proposals on Presentation

- **The margin presentation model** in the 2010 ED was developed from two key conclusions made by the Board:
  - Presentation of an insurer's profit or loss is better expressed from the building-blocks model
  - A margin approach is the most suited presentation to display the sources of profit from the building-blocks model
- However, based on feedback received, including industry outcry for volume information, the 2013 ED now requires presentation of insurance revenue – a metric derived from the building blocks model.

Statement of Financial Position (aka Balance Sheet)

Items proposed in the ED

- An insurer shall present separately, as a single line item, the carrying amount of the portfolios of insurance contracts that are assets from insurance contract liabilities
- An insurer shall not offset reinsurance assets or liabilities against direct insurance contract assets or liabilities
- For unit-linked contracts, the pool of assets underlying these contracts shall be presented as a single line item and not commingled with the insurer's other assets
- The portion of the liabilities linked to the pool of assets shall be presented as a single line item and not commingled with the insurer's other insurance contract liabilities

Statement of Comprehensive Income (Income Statement)

Other items the ED proposes

- An insurer should present premiums, claims, benefits, and the gross underwriting margin in the SCI.
- Insurers should exclude from the aggregate premium presented in the SCI income the present value of the amounts the insurer is obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs, determined consistently with measurement of the overall insurance contract liability.
- It should be required to present in OCI changes in the insurance liability arising from changes in the discount rate and to present in profit or loss interest expense using the discount rate locked in at inception of the insurance contract.
- Reinsurers and cedants shall present any gains or losses on commutations as an adjustment to claims or benefits and should not gross up the premiums, claims, or benefits in recognizing the transaction on the SCI.

Statement of comprehensive income

Exposure Draft

Insurance contract revenue	X
Claims and benefits incurred	(X)
Amortization of acquisition costs	(X)
Changes in estimates for future claims	(X)
Unwind of previous changes in estimates	X
Total Underwriting Margin	X
Investment income	X
Interest accreted on insurance contracts	(X)
Profit	X
Components of other comprehensive income	X
Total comprehensive income	X

Presentation of Insurance Revenue

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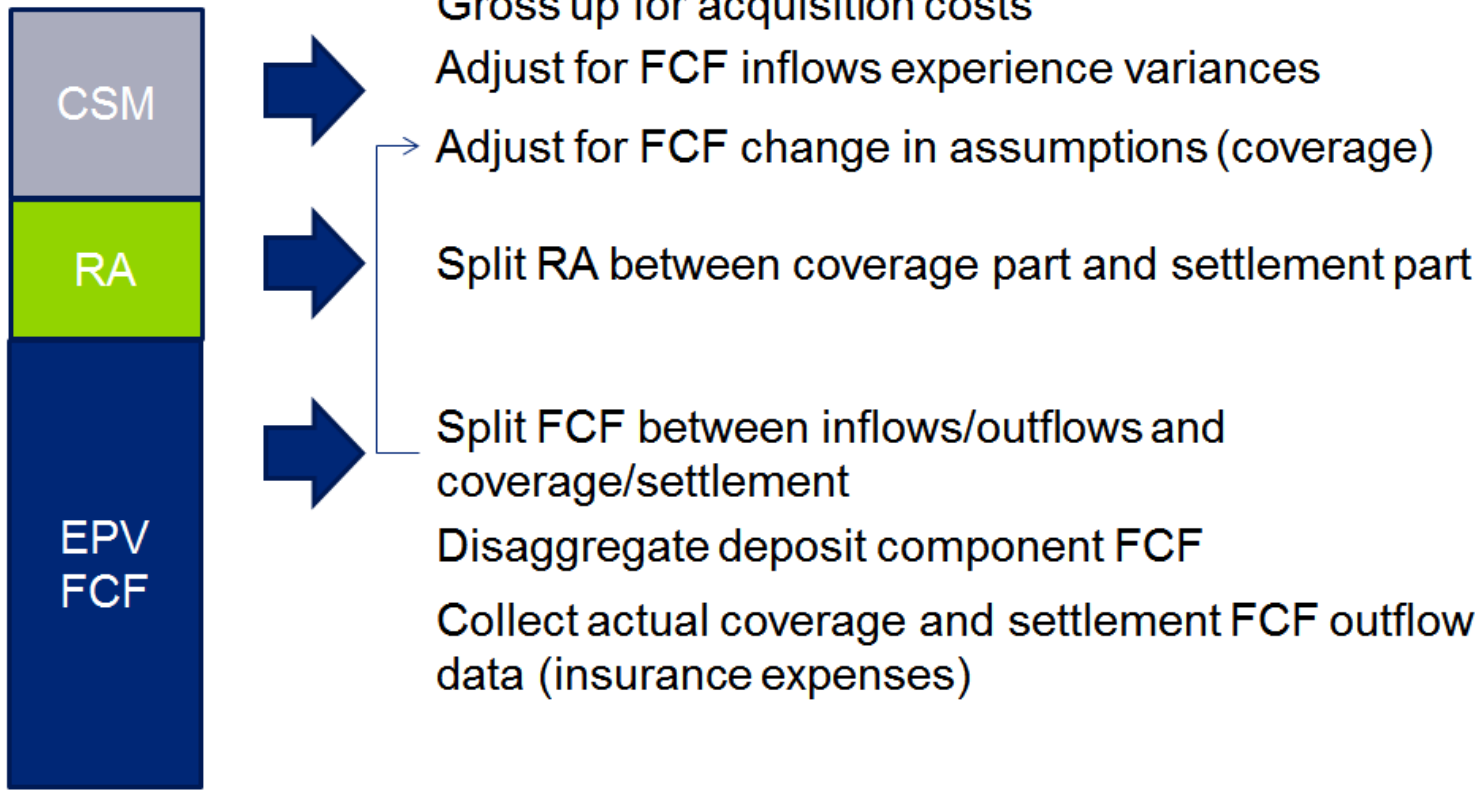
Linking liability movements to revenue and expense



Presentation of Insurance Revenue

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Linking liability movements to revenue and expense

- Revenue is formula driven based on
  - release of contractual service margin
  - period expected cash outflows
  - acquisition cost period allocation
  - risk adjustment change

- Expected outflows are split between those relating to future coverage and services and those beyond the expiry of that period (settlement cash flows). Only those outflows relating relating to the coverage period are recognized as revenue/
- Outflows representing repayments of deposit components (“returnable amounts”) are excluded.
- Net experience variances on inflows (premiums) that relate to future coverage are added to the revenue together in line with the changes in CSM recognized through earnings and the changes in the risk adjustment related to future coverage net cash flows.
- Amounts derived from the CSM are grossed up for direct acquisition costs which are presented as an expense using an amortization pattern that mirrors the release of the CSM through earnings.

Presentation of Insurance Revenue

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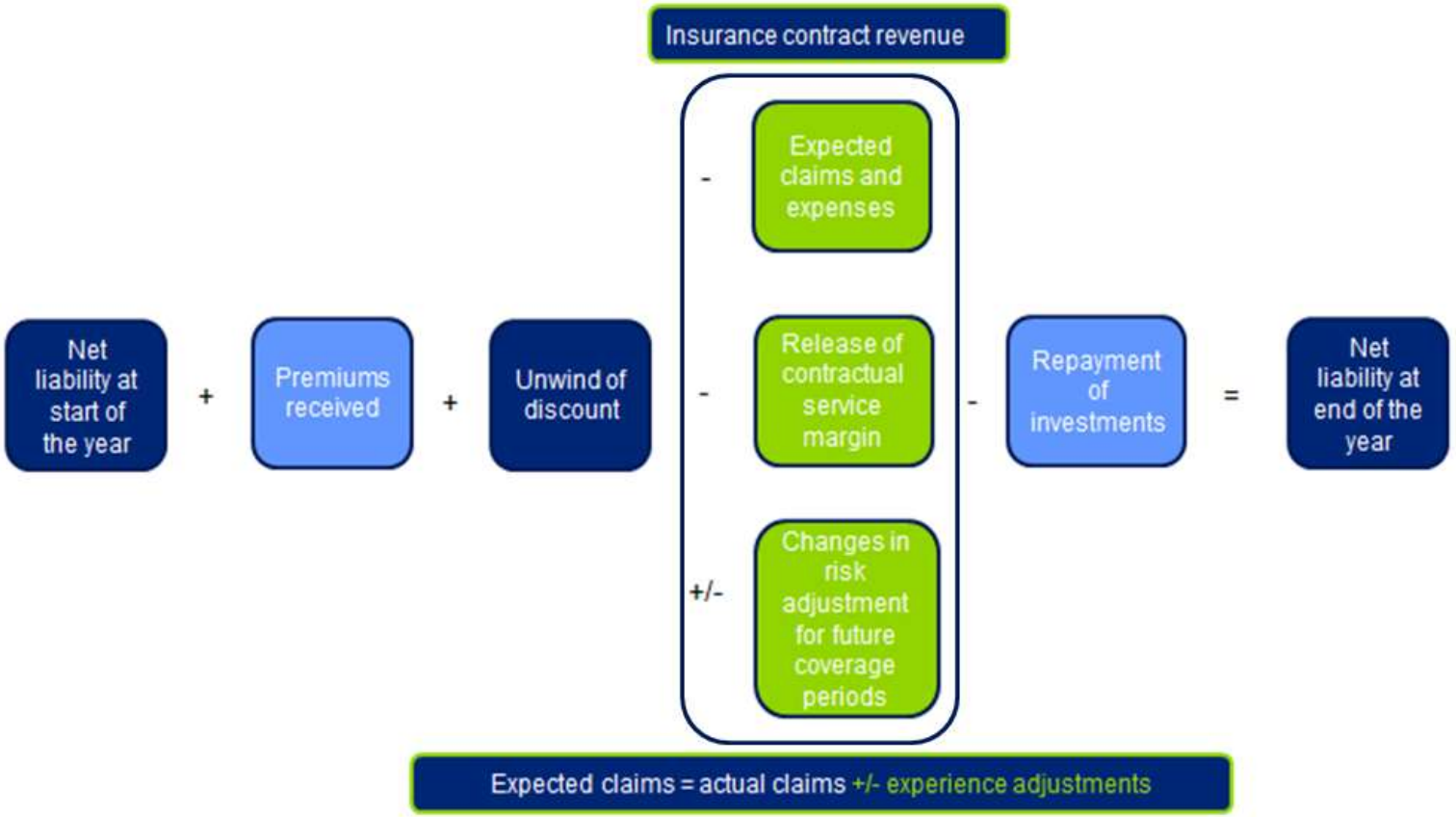
Linking liability movements to revenue and expense



Key issues and concerns

- Does the revenue metric address industry concerns?
- Is a revenue measure that is unrelated to premiums collected acceptable to stakeholders?
- Is it too complex?
- What type of volume information are investors looking for? Does ignoring investment components meet these needs?

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OCI

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OCI, what is it?

- Other comprehensive income
- A way to remove “X” from impacting the income statement but still have it show up in the balance sheet and statement of comprehensive income
- “X” could be:
  - Spurious or short term volatility
  - An accounting mismatch
  - Something that is not part of the core underlying earnings
  - Something a company wishes was not part of the core underlying earnings

Why are we discussing OCI?

- The original ED required **all** the movements in liabilities be recognized in income statement and that these liabilities be measured at **current values** which is unique to the insurance industry.

- Most of the users and preparers agreed with the measurement but not the reporting:
  - Recognition of short-term volatility in profit or loss caused by changes in discount rate does not reflect the long-term nature of the insurance liability
  - These short-term impacts will naturally reverse over time as claims are ultimately paid
  - It will obscure the underlying long-term performance

- They therefore suggested that short-term volatility caused by changes in discount rate should be presented in OCI
  - Others notes this would help make insurers more comparable to other industries

Why are we discussing OCI?

- In response current ED includes this concept of OCI:
  1. To reduce short term volatility caused by discount rate changes that are expected to reverse over time
  2. To enhance transparency of core underwriting such that they are not overshadowed by changes in market interest rates
  3. To reduce accounting mismatches in the income statement between the insurance liability measurement and related assets recorded at either amortized cost or available for sale through OCI

How should OCI be applied?

- The ED specifies that the following should be moved to OCI:
  - Changes in the insurance liability arising from changes in the discount rate
  - Changes in the insurance liability arising from changes in interest sensitive cash flow assumptions (such as minimum crediting rates and lapse assumptions)
  - All these changes regardless of whether or not they reduce accounting mismatches – it is NOT optional
  - Once insurance contract is derecognized, any remaining OCI amounts should flow back through the P&L

Mechanics of the calculations

- The income statement discount rate used should be the rate locked in at inception of the contract
  - How to determine this locked-in rate is not specified
- No loss recognition testing will apply to the income statement balances
  - Even if the liabilities underlying the income statement are insufficient to cover the future cash flows, no adjustment would be made
  - However, the balances sheet and total comprehensive income will still use current discount rates and cash flows

What is the “locked-in” rate?

At issue date, the following are assumed:

Year	1	2	3	4	5
Yield to maturity	1.00%	1.50%	2.00%	2.49%	2.99%
Forward rate	1.00%	2.00%	3.00%	4.00%	5.00%
Cash out flow	50	100	200	300	400

Leading to an annual effective rate of 2.58%

What is the locked-in rate?

What is the "locked-in" rate?

Year	1	2	3	4	5
Yield to maturity	1.00%	1.50%	2.00%	2.49%	2.99%
Forward rate	1.00%	2.00%	3.00%	4.00%	5.00%
Cash out flow	50	100	200	300	400

Options might include:

- The forward rates – these could be bought in the marketplace
- The annual effective rate – most like the asset accounting
- The YTM on each year's cash flow – something between the other two

What is the "locked-in" rate?

Year	1	2	3	4	5
Yield to maturity	1.00%	1.50%	2.00%	2.49%	2.99%
Forward rate	1.00%	2.00%	3.00%	4.00%	5.00%
Cash out flow	50	100	200	300	400

Projected reserve to run through the P&L					
Year	1	2	3	4	5
Ann eff yield	952	927	851	673	390
Spots	952	925	848	670	388
Forwards	952	912	830	655	381

How will it work?

Following assumptions:

- Single premium product pays $1000 at the end of 10 years, but depend indirectly on the earned rate
- Original discount rate is 5% for all years

By the end of the first year, rates have gone down to 4% and $1000 is still expected to be paid at the end of the term.

By the end of the second year, the company assumes the rate decline is permanent and as a result the ultimate cash flow is reduced to $963

How will it work?

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Undiscounted CF	1000	1000	1000	963	963	1000	963	963
Disc Rate	5%	5%	5%	4.51%	4.51%	4%	4%	4%
YTM	10	9	8	8	7	9	8	7
BOP balance	614	645	677	677	707	703	704	732

	Year 1	Year 2	Year 3
BOP PnL	614	645	677
EOP PnL	645	677	707

BOP BS	614	703	704
EOP BS	703	704	732

OCI total	(58)	(27)	(24)
OCI period	(58)	31	2

What will it mean for reporting?

- Volatility in the income statement should be dramatically decreased
  - However, if assets supporting the liabilities move with interest rates, the liabilities will not potentially introducing volatility
- Insurers will need to include yet another run of their models to complete the income statement
- The income statement investment earning spread will be based on initial assumptions while the balances sheet is based on current assumptions
  - This may result in changes to spreads from inception being recognized only as they are realized
- The cash flows underlying the balances in the income statement may not match the cash flows underlying the balances in the balance sheet
  - This may drive experience variances in the income statement that are not appropriate

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Asset Accounting IFRS 9

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What's changing?

A new financial instrument standard (IFRS 9) being introduced, covering:

Measurement

Classification

Impairment

Hedging

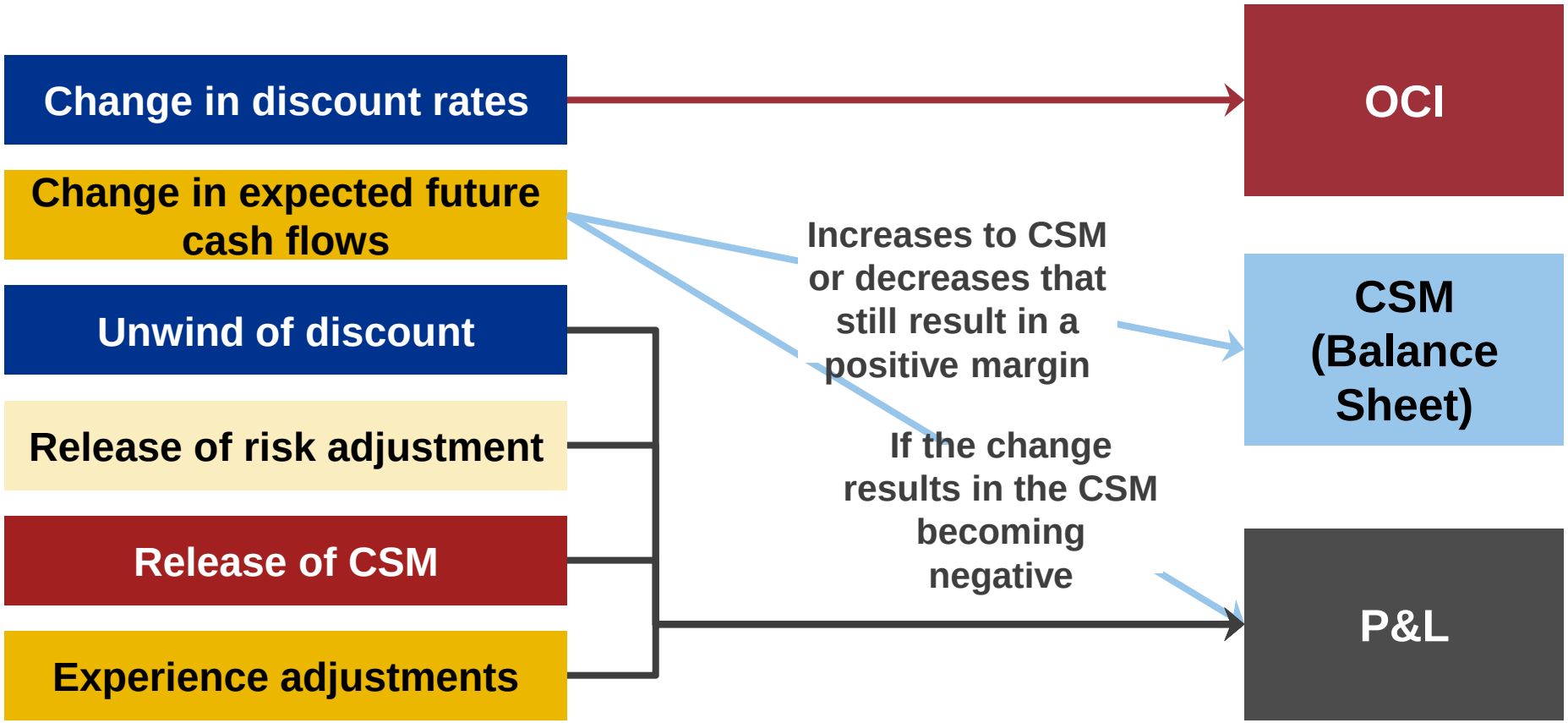
Why does it matter?

- Different classification ➔ different amount in the accounts
- Different classification ➔ changes in value recorded in different places in the accounts
- Possible accounting mismatch with liabilities!

Accounting for assets: 3 main classifications

- Amortised cost
- Fair value through profit and loss
- Fair value through other comprehensive income

Release of the Liability - Recap



Examples of different classifications

- Assume a plain vanilla corporate bonds backing a set of insurance liabilities
- Assume amounts, currencies, maturities etc. of assets and liabilities are broadly matched (i.e. no significant economic mismatch)
- No changes to credit spreads
- Cash flows remain consistent with original assumptions throughout the life of the contract
- Ignore effects of:
  - Amortisation of premium/discount on purchase of bond
  - Unwind of discount
  - Interest income/interest on margin

1) Amortised cost

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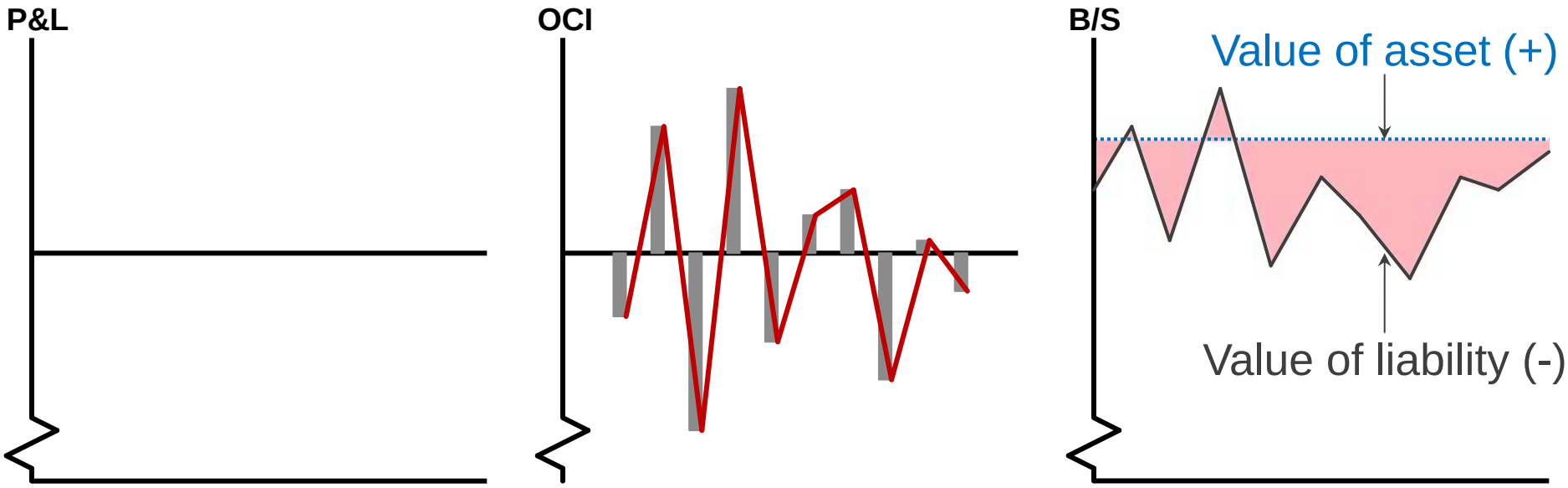
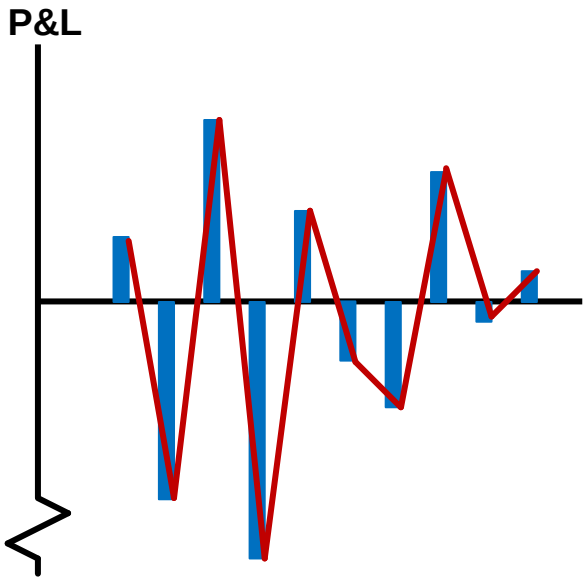
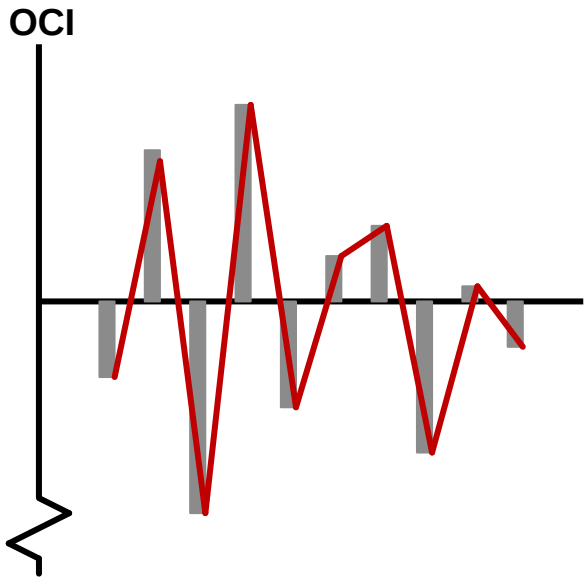
- Value of liability changes as a result of impact of changes in interest rate on the discount rate (change goes through OCI)
- Accounting value of asset not affected by interest rate movements (although impacted by amortisation / impairment)

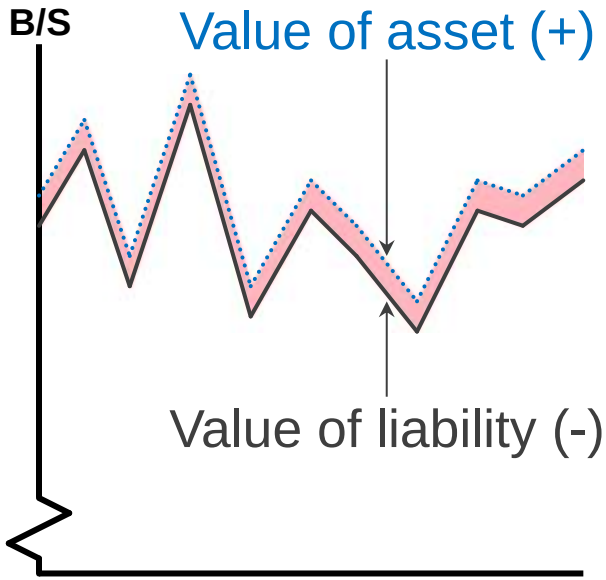


2) Fair value through P&L

- Change in value of assets (as a result of changing interest rates) to P&L
- Change in the value of liabilities (discount rate) to OCI
- Impacts largely offset in balance sheet, but mismatch in P&L and OCI

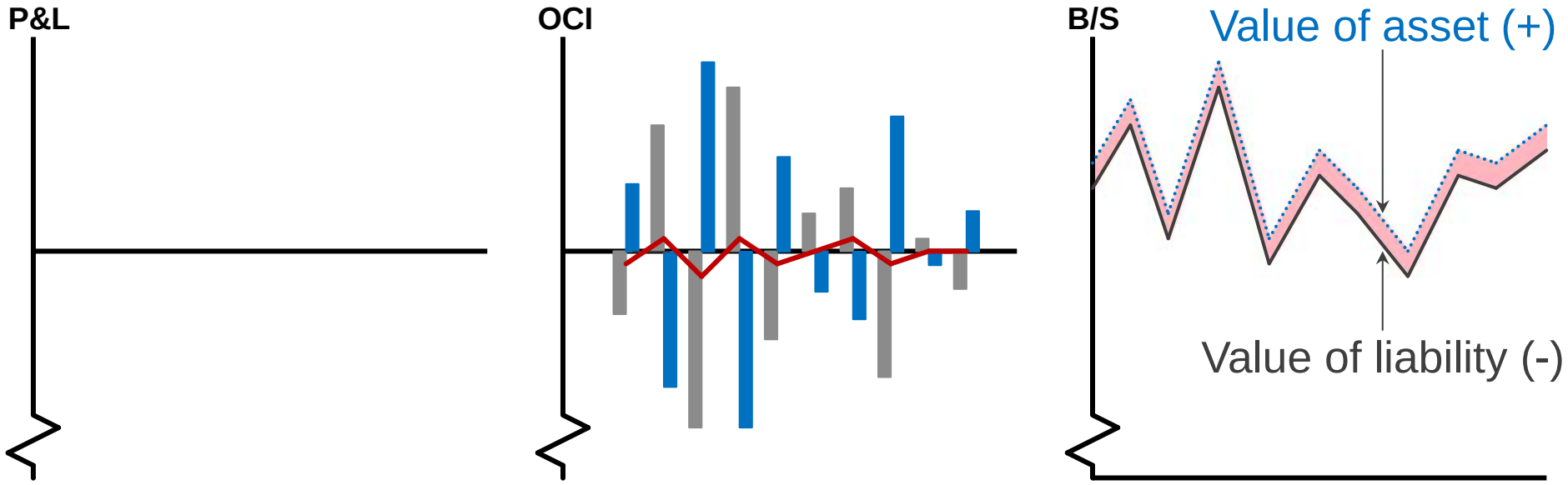






3) Fair value through OCI

- Change in value of assets (as a result of changing interest rates) to P&L
- Change in the value of liabilities (discount rate) to OCI
- Impacts largely offset in balance sheet and OCI, minimal mismatch



How are assets classified?

- According to the business model in which they're held:

Business Model	Classification
Assets held to collect contractual cash flows (CCF)	Amortised cost
For capital appreciation	Fair value through P&L
Collect CCF or for income/capital appreciation	Fair value through OCI

A word on effective dates

- Effective date for IFRS 9: 2016 or 2017?
- Effective date for Insurance Standard: 2018?
- So companies may have to apply IFRS 9 before the new insurance contracts standard:
  - "The IASB understands the importance of the interaction between the accounting for insurance contracts and financial assets."

In summary

Actuaries
Risk is Opportunity.

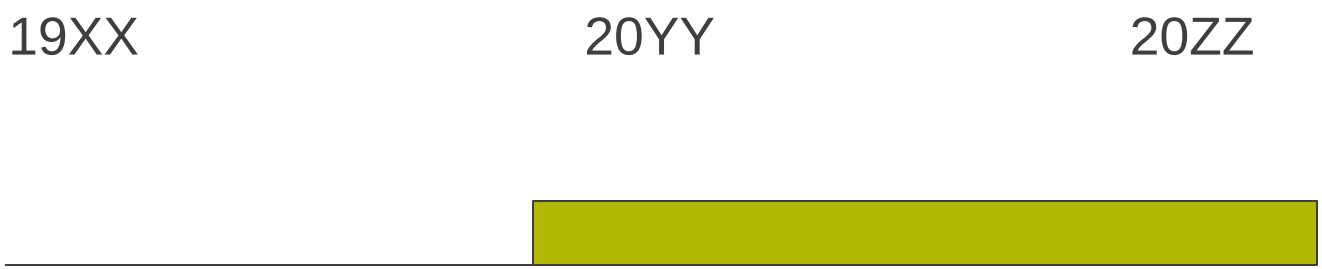
- Classification is based on how the assets are actually used, 3 categories:
  - Amortised cost
  - Fair value through profit and loss
  - Fair value through other comprehensive income
- Classification affects the accounting treatment of the assets (presentation and value in the accounts)
- Classification of assets affects the reported results of the insurer from period to period
- Like insurance accounting, the different accounting approaches affects ***when*** profits/losses are recognised from a transaction, not the ultimate economics

Actuaries
Risk is Opportunity.®

Transition

SOCIETY OF ACTUARIES

Transition time line



Change in Accounting

Application of this Standard is a change in accounting policy. As such, under IAS 8 applies

Recognise cumulative effect at beginning of earliest period presented by adjusting:

- Opening retained earnings
- Opening accumulated OCI

Opening Adjustments

At the beginning of the earliest period presented, an entity shall …

Measure each portfolio of insurance contracts as sum of:

(i) the fulfillment cash flows; and

(ii) a contractual service margin

Opening adjustments, Cont.

Recognise, in a separate component of equity, i.e. OCI,

The cumulative effect of difference between expected present values of cash flows at beginning of earliest period presented, discounted using:

(i) current discount rates at earliest period; and

(ii) the discount rates applied when portfolios were initially recognised

Practicality

When it would be impracticable to apply this Standard to measure an insurance contract retrospectively, at the beginning of the earliest the earliest period presented an entity shall measure the insurance contract at the sum of:

(i) fulfillment cash flows (i.e. BEL + risk adjustment)

and

(ii) an estimate of the remaining contractual service margin based on expectations at contract initial recognition.

Estimate expected cash flows at date of initial recognition as

- expected cash flows at the beginning of the earliest period presented, adjusted by
- cash flows known to have occurred between date of initial recognition and beginning of earliest period presented

Estimating risk adjustment

R**isk adjustment** at date of initial recognition is estimated as:

- risk adjustment that is measured at beginning of earliest period presented.

  Risk adjustment does not reflect changes in risk between initial recognition and earliest period presented.

Estimating discount rates

E**stimate discount rates** that applied at date of initial recognition using

- An observable yield curve that, for at least three years before the date of transition, approximates the yield curve estimated, if such an **observable yield curve exists**;
- Otherwise **estimate discount rates** that applied at date of initial recognition by
  - determining an average **spread** between an observable yield curve and yield curve estimated, and
  - applying that spread to that observable yield curve.

  That spread shall be an average over at least three years before the date of transition

Redesignation of financial assets

At transition it is permitted, but not required to redesignate a financial asset as measured at fair value through P&L if that financial asset meets the condition in IFRS 9.